HOUSING MARKET INFORMATION

HOUSING MARKET OUTLOOK
Sherbrooke CMA

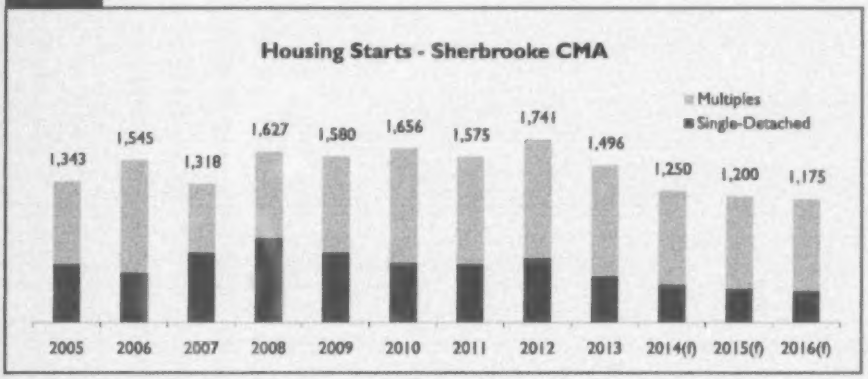
CANADA MORTGAGE AND HOUSING CORPORATION

Date Released: Fall 2014

Highlights

- The decline in housing starts will continue at a slower pace in 2015 and 2016.
- The existing home supply will decrease following a rebound in sales that will begin in 2015, but this will not be sufficient for the resale market to become balanced by 2016.
- The growth in the average price on the resale market will be minimal.
- Despite an increase in the supply of rental units, the vacancy rate will remain stable in 2015 and 2016.

Figure 1



Source : CMHC f : CMHC forecasts

The outlook is subject to uncertainty. Although point forecasts are presented in this publication, CMHC also presents risks where appropriate. The forecasts and historical data included in this document reflect information available as of October 22, 2014.

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New home market: all segments to record decreases this year

The trends that impacted residential construction in 2013 will continue in 2014 in the Sherbrooke census metropolitan area (CMA). The continued easing of the labour market in 2013, with a drop of 4.1 per cent in employment, had negative repercussions on the overall real estate market. The downward trend in existing home sales that began in 2012 extended into this year. At the same time, the supply of properties on both the resale and new home markets continued to grow, staying at historically high levels.[1] Inevitably, residential construction will slow down once again this year, affecting both the single-detached and multi-unit housing segments with declines of similar magnitudes. In 2015 and 2016, activity on the new home market is not expected to bounce back. It will continue to decrease, but to a lesser degree than in 2013 and 2014.

Foundations were laid for 850 units in the Sherbrooke CMA during the first nine months of 2014, which represents a decrease of close to 9 per cent over the same period in 2013. Since the strong activity recorded in December 2013 with the start of a large project will not occur again this year, the level of new units for the year overall will register a greater drop, falling by 16 per cent to 1,250 units. In 2015 and 2016, starts should remain at around 1,200 units annually.

The trend in housing starts by unit type indicates that single-detached home construction will continue to slow down. Foundations should be laid for 360 homes this year, or 92 fewer than in 2013. In 2015 and 2016, starts in this market segment should reach around 300 units. The abundant supply of more affordable existing single-detached houses should temper the demand for new homes. It should be mentioned that a regulatory change adopted this past February by the City of Sherbrooke could put upward pressure on new home prices through the cost of the lots.[2] This could therefore cause the demand for new homes to shift to comparable existing homes, since the higher prices will reduce the affordability of new homes.

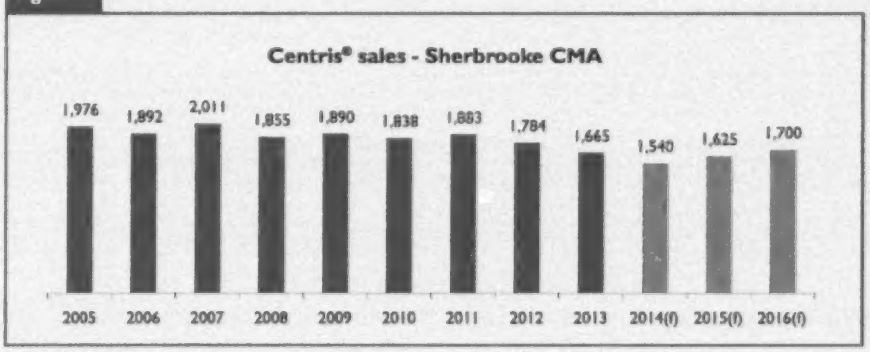
Multi-unit housing starts, for their part, should decrease slightly in 2015 and 2016 after falling significantly this year. As explained in the text box, the inventory of semi-detached and row homes has been steadily rising, signalling that the construction of units of this type will likely not rebound. While demand for new apartments remains strong, a significant number of units will be completed in 2015. Construction in this segment should therefore not be expected to pick up in the short term.

Existing home market: demand to regain strength

Since the 2008-2009 recession, the resale market in the Sherbrooke CMA has not posted a sustainable recovery. For the third year in a row, the number of Centris® transactions will decrease in 2014 (-7.5 per cent) and should reach a low at slightly over 1,500 transactions.

This weak demand was the result of both the significant decrease in employment in 2013 and the latest tightening of mortgage financing rules. The trend reversed this year, with employment growth exceeding 3.7 per cent from January to September compared to the same period in 2013. We can therefore expect a greater number of buyers on the resale market in 2015, which will have an impact on the volume of transactions.

Figure 2



Source : QFREB by Centris® f : CMHC forecasts

[1] In the third quarter, some 2,700 dwellings were available, excluding vacant rental units, for a ratio of 16 dwellings per 1,000 inhabitants aged 15 years or older, compared to a ratio of 12.3 per 1,000 in 2008, the year in which the QFREB began publishing data on the resale market.

[2] Developers are now responsible for all the related costs, including the expenses for the construction of a water retention pond—costs that were previously assumed by the City of Sherbrooke.

This rise in activity will also help to reduce the supply. It should be recalled that, during the period from 2008 to 2012, the steady pace of starts combined with the slowdown in sales contributed to increasing the number of properties for sale on the existing home market. This phenomenon has continued this year, as the number of active listings jumped by 12 per cent from January to September[3] over the same period in 2013, pushing the average time to sell to an all-time high. In the third quarter of this year, it took on average 122 days to sell a single-detached home,[4] compared to 88 days in the fourth quarter of 2008, when this data began being published. The resale market has been favourable to buyers since 2012 due to the more abundant supply combined with the decrease in demand.

As previously mentioned, net employment gains should support the rebound in housing demand over the next two years. In addition to better economic conditions, the still historically low mortgage rates will sustain demand. In 2015, transactions should climb by 5.5 per cent to exceed the 1,600-unit threshold. A similar raise is expected for 2016, as transactions should rise by 4.6 per cent to 1,700 sales. Even with this growth, these volumes will remain below the levels recorded in recent years. In addition, the expected rise in demand will not be sufficient to significantly reduce the number of properties for sale on the market, which is continuously fuelled by new listings. Consequently, the market will remain favourable to buyers, despite the slight tightening that will begin in 2015.

Figure 3

* The market is generally considered to be balanced when this ratio is between 8 and 10.
Source : QFREB by Centris® f : CMHC forecasts

This situation will obviously limit the increase in the average price, which should rise by no more than 1 per cent annually until 2016, to reach $236,000—a much slower pace than the rate recorded over the last 10 years (6.6 per cent on average).

Rental market: break in the rising vacancy rate trend

Given the relatively favourable mortgage rates, many renters became homeowners in recent years. That being said, these first-time homebuyers opted mainly for the most affordable housing types, such as semi-detached houses, row homes and condominiums. This situation, combined with the sustained construction of rental units, pushed up the rental vacancy rate. In 2013, the average vacancy rate in the Sherbrooke area reached 5.3 per cent—the highest among the rates recorded in the six metropolitan areas across Quebec. At the same time, the vacancy rate for newer rental buildings—built in 2000 or later—was below the 3-per-cent mark, reflecting the sustained demand for such dwellings. In fact, rental housing starts were fuelled by the start of several large projects in the last year.

At the end of 2014, the overall vacancy rate should decrease to 5.0 per cent. The significant slowdown in the movement to homeownership and the increase in net migration in the area are the main factors supporting demand. In 2015, the rise in supply should put upward pressure on the vacancy rate (5.2 per cent), as a large number of units will be completed, which should drive up the average rent.

In 2016, the growth of the housing stock and the expected recovery of the demand on the resale market will push the vacancy rate upward. These factors will be offset by employment growth and policies aimed at increasing the area's net migration (see the following section). As a result, the vacancy rate should remain at 5.2 per cent.

[3] Source: QFREB Barometer – Residential Market, Sherbrooke CMA, Third Quarter 2014, Centris®, p.6.
[4] *Ibid.*

Economic trends: employment to pick up significantly and net migration to rise

The past few years were particularly austere for the job market in the Sherbrooke CMA. In fact, nearly 5,000 net jobs were eliminated between 2011 and 2013,[5] for a decrease equivalent to 5 per cent of all jobs. This year, employment should rebound significantly (+4.0 per cent), for a total net gain of 3,300 jobs, of which 80 per cent are full-time.

However, over the next two years, employment should grow at a slower pace. While the economic outlook is generally favourable for the area and the province, employment growth will be moderated by the weaker expansion of the labour supply. This explains why we expect the unemployment rate to decrease considerably over the forecast horizon. Conversely, employment, measured as a proportion of the population, should not rise significantly, since the population will grow essentially at the same pace as employment. Demographic growth will be mainly fuelled by people 60 years or older, which currently account for 25 per cent of the CMA's population.

Nevertheless, the weak Canadian dollar and strengthening economic growth in the United States should stimulate employment growth in the area. In fact, exporting companies and the tourism industry are benefiting from a Canadian dollar that has steadily stayed below par with the U.S. dollar since the beginning of 2013. This context is bringing some respite to the Eastern Townships manufacturing sector, which saw its production decrease by a third over the last decade. Also, the area's economy should gain from the expected acceleration in the recovery south of the border.

Figure 4

Source : CMHC f : CMHC forecasts

On the migration front, net migration has remained positive year after year for more than 10 years, having exceeded 2,000 people for the second year in a row in 2013. Immigration contributes to net migration in a greater proportion than before, and its share is in fact bound to expand, given that a specific immigration agreement in the Eastern Townships, revealed last spring, will attract more immigrants to the Sherbrooke area. This agreement should help fulfill labour needs.

Also, net interregional migration remains positive in the area, fuelled by all age cohorts except first-time homebuyers. In the past ten years, more people aged from 25 to 39 left the area annually than came in, which has slowed the growth of the first-time homebuyer population.

Notwithstanding the increase in net migration, net household formation will be more moderate in the CMA,[6] at around 1,100 households in 2015 and 2016, which is in line with a need for fewer housing starts.

Overall, the increase in international migration and the aging of the population are factors that will stimulate demand for multi-unit housing, especially apartments, to the detriment of single-detached homes. According to our forecasts, there will be three multi-unit dwellings built for every single-detached house starting in 2016. However, fewer households will form year after year, and this will have a negative impact on the underlying demand for new homes.

[5] The average employment level in 2011 was 99,000 jobs according to Statistics Canada's Labour Force Survey compared to 94,125 in 2013.

[6] The Institut de la statistique du Québec published an updated version of its demographic outlook in early September. See Perspectives démographiques du Québec et des régions, 2011-2061.

Mortgage rates are expected to remain unchanged until the latter months of 2015

Consistent with the view of Canadian economic forecasters, CMHC expects interest rates to remain unchanged until the latter parts of 2015 and then begin to increase gradually. Gradual increases in mortgage rates from historic lows are not expected to significantly impact housing demand.

According to CMHC's base case scenario for 2014, CMHC expects the one-year mortgage rate to be in the 3.00 to 3.25 per cent range, while the five-year rate is forecast to be within the 5.00 to 5.50 per cent range. For 2015, the one-year mortgage rate is expected to be in the 3.20 to 4.00 per cent range, while the five-year rate is forecast to be within the 5.25 to 6.00 per cent range. For 2016, the one-year mortgage rate is expected to be in the 3.70 to 4.60 per cent range, while the five-year rate is forecast to be within the 5.55 to 6.45 per cent range.

Trends at a glance

Key Factors and their Effects on Housing Starts	
Mortgage Rates	Mortgage rates will remain low by historical standards and will continue to support housing demand.
Employment	After decreasing in 2013, employment rebounded in 2014 and will remain stable in 2015 and 2016. This will promote the rise in housing demand. However, the aging of the population will moderate the pace of job creation.
Income	Average weekly earnings continued to increase in 2014 (by about 2 per cent), at a pace similar to the inflation rate. Stagnant real income growth could slow down housing demand.
Population	The composition of net migration and the aging of the population will further support demand for apartments and rental units. In the medium term, housing starts will be hampered by lower net household formation.
Resale Market	Conditions on the resale market will remain favourable to buyers, even in 2016, which will slow the growth in prices. The easing of the resale market will have a negative impact on the demand for new housing.

Forecast risks

- The depreciation of the Canadian dollar may not have the expected positive impacts on the CMA's economic growth. Employment growth could then be more moderate than anticipated. Should this be the case, the expected recovery on the resale market could be weaker.
- The impact of the municipal regulatory on the cost of the lots could be more or less significant. The subsequent effect on residential development could therefore be more or less significant than anticipated.
- The actual impacts of the specific immigration agreement and their timing could affect our net migration forecasts and, consequently, have a different effect on housing demand.

Spotlight on...

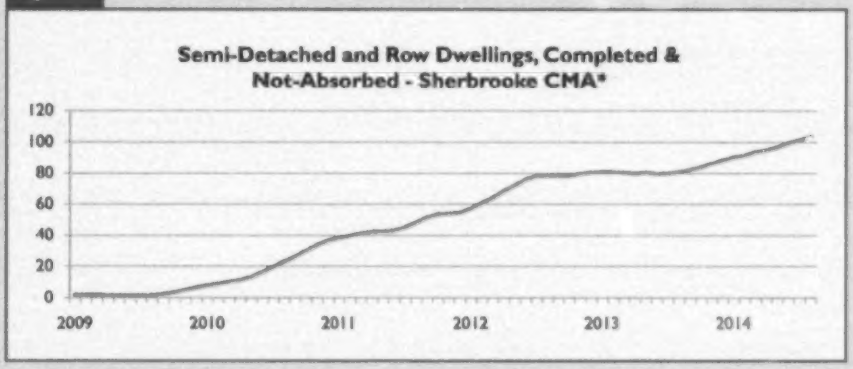
Semi-detached and row housing inventories

Starts of such houses, which are popular among first-time homebuyers, thanks to their greater affordability, had risen significantly from 2009 to 2012. During that period, their share of total housing starts more than doubled, rising from 11 per cent in 2009 to 27 per cent in 2012. However, the activity was limited, in part, by the tightening of the mortgage financing rules in 2012, which had a more significant impact on first-time homebuyers.

Despite a decline of nearly 30 per cent in semi-detached and row housing starts in 2013,[7] the inventory of new vacant homes continued to increase in the Sherbrooke area. Therefore, the pace of construction should be expected to keep slowing down this year (15 per cent). With this adjustment, the low point should be reached (280 housing starts).

While demand fundamentals are pointing to an overall slowdown in housing construction, the share of semi-detached and row housing starts should surpass that of single-detached home starts beginning in 2016. The growth in the first-time homebuyer population, aged between 25 and 34, will remain positive, albeit slower, at least until the end of the current decade.[8] This factor, along with the higher cost of lots following a regulatory change, will stimulate demand for this more affordable housing type to the detriment of single-detached houses.

Figure 5



*Smoothed data using a twelve-month moving average. Source: CMHC

[7] This situation was mentioned in the fall 2013 *Housing Market Outlook* report.

[8] The Institut de la statistique du Québec published an updated version of its demographic outlook in early September. See Perspectives démographiques du Québec et des régions, 2011-2061.

Forecast Summary Sherbrooke CMA Fall 2014									
	2011	2012	2013	2014(F)	% chg	2015(F)	% chg	2016(F)	% chg
New Home Market									
Starts:									
Single-Detached	557	610	442	360	-18.6	320	-11.1	300	-6.3
Multiples	1,018	1,131	1,054	890	-15.6	880	-1.1	875	-0.6
Starts - Total	1,575	1,741	1,496	1,250	-16.4	1,200	-4.0	1,175	-2.1
Average Price ($)									
Single-Detached	256,365	279,010	303,165	306,000	0.9	315,000	2.9	318,000	1.0
Median Price ($):									
Single-Detached	235,000	260,000	292,500	297,000	1.5	307,000	3.4	310,000	1.0
New Housing Price Index (% chg) (Que.)	2.6	1.7	1.0	n.a.	-	n.a.	-	n.a.	-
Resale Market									
Centris® Sales	1,883	1,784	1,665	1,540	-7.5	1,625	5.5	1,700	4.6
Centris® New Listings	3,630	3,578	3,338	3,500	4.9	3,300	-5.7	3,250	-1.5
Centris® Active Listings	1,509	1,666	1,673	1,900	13.6	1,875	-1.3	1,800	-4.0
Centris® Average Price ($)	214,358	216,662	229,483	230,000	0.2	233,500	1.5	236,000	1.1
Rental Market									
October Vacancy Rate (%)	4.7	5.0	5.3	5.0	-0.3	5.2	0.2	5.2	0.0
Two-bedroom Average Rent (October) ($)	577	578	591	600	1.5	620	3.3	635	2.4
Economic Overview									
Mortgage Rate (1 year) (%)	3.52	3.17	3.08	3.00 - 3.25	-	3.20 - 4.00	-	3.70 - 4.60	-
Mortgage Rate (5 year) (%)	5.37	5.27	5.24	5.00 - 5.50	-	5.25 - 6.00	-	5.55 - 6.45	-
Annual Employment Level	99,000	98,100	94,100	97,900	4.0	98,400	0.5	99,400	1.0
Employment Growth (%) - excluding Magog	6.9	-0.9	-4.1	4.0	-	0.5	-	1.0	-
Unemployment rate (%)	6.9	7.5	7.0	7.5	-	7.1	-	6.7	-
Net Migration	1,852	2,067	2,029	2,150	6.0	2,275	5.8	2,425	6.6

[1]The Centris® system contains all the listings of Québec real estate brokers.

[2]Source: CMHC (Starts and Completions Survey, Market Absorption Survey), adapted from Statistics Canada (CANSIM), Statistics Canada (CANSIM), Centris® Statistics. CMHC Forecast (2014-2016)

NOTE: Rental universe = Privately initiated rental apartment structures of three units and over

DEFINITIONS AND METHODOLOGY

New Home Market

Historical home starts numbers are collected through CMHC's monthly **Starts and Completions Survey**. Building permits are used to determine construction sites and visits confirm construction stages. A **start** is defined as the beginning of construction on a building, usually when the concrete has been poured for the whole of the structure's footing, or an equivalent stage where a basement will not be part of the structure.

Single-Detached Start:
The start of a building containing only one dwelling unit, which is completely separated on all sides from any other dwelling or structure.

Semi-Detached Start:
The start of each of the dwellings in a building containing two dwellings located side-by-side, adjoining no other structure and separated by a common or party wall extending from ground to roof.

Row (or Townhouse) Start:
Refers to the commencement of construction on a dwelling unit in a row of three or more attached dwellings separated by a common or party wall extending from ground to roof.

Apartment and other Starts:
Refers to the commencement of construction on all dwellings other than those described above, including structures commonly known as stacked townhouses, duplexes, triplexes, double duplexes and row duplexes.

Average and Median Single Detached Home Prices:
Are estimated using CMHC's **Market Absorption Survey**, which collects home prices at absorption and measures the rate at which units are sold or rented after they are completed. Dwellings are enumerated each month after a structure is completed until full absorption occurs. The term "**absorbed**" means that a housing unit is no longer on the market as it has been sold or rented.

New Home Price Indexes:
Changes in the New Home Price Indexes are estimated using annual averages of Statistics Canada's monthly values for New Housing Price Indexes (NHPI).

Resale Market

Historical resale market data in the summary tables of the Housing Market Outlook Reports refers to residential transactions through the Multiple Listings Services (MLS®) as reported by The Canadian Real Estate Association (CREA). In Quebec, this data is obtained by the Centris® listing system via the Quebec Federation of Real Estate Boards.

MLS® (Centris® in the province of Quebec) Sales:
Refers to the total number of sales made through the Multiple Listings Services in a particular year.

MLS® (Centris® in the province of Quebec) Average Price:
Refers to the average annual price of residential transactions through the Multiple Listings Services.

Rental Market

Rental Market vacancy rates and two bedroom rents information is from Canada Mortgage and Housing Corporation's (CMHC's) October Rental Market Survey (RMS). Conducted on a sample basis in all urban areas with populations of 10,000 and more, the RMS targets privately initiated structures with at least three rental units, which. have been on the market for at least three months. The survey obtains information from owners, managers, or building superintendents through a combination of telephone interviews and site visits.

Vacancy Rate:
The vacancy rate refers to the average vacancy rate of all apartment bedroom types. A unit is considered vacant if, at the time of the survey, it is physically unoccupied and available for immediate rental.

Two Bedroom Rent:
The rent refers to the average of the actual amount tenants pay for two bedroom apartment units. No adjustments are made for the inclusion or exclusion of amenities and services such as heat, hydro, parking, and hot water.

Economic Overview

Labour Force variables include the Annual Employment Level, Employment Growth, Unemployment Rate. Source: Statistics Canada's Labour Force Survey.

Net Migration:
Sum of net interprovincial (between provinces), net intra-provincial (within provinces), net international (immigration less emigration), returning Canadians and temporary (non-permanent) residents as provided to the CANSIM database by Statistics Canada's Demography Division. Sources of inter-provincial and intra-provincial migration data include a comparison of addresses from individual income tax returns for two consecutive years from Canada Revenue Agency (CRA) taxation records. The migration estimates are modelled, with the tax file results weighted to represent the whole population.

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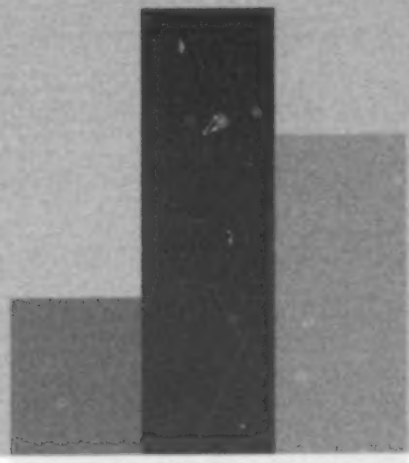

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